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INDEX

CITATIONS

130338—39——1

In the Supreme Court of the United States

OCTOBER TERM, 1938

No. 65

DOUGLAS FAIRBANKS, PETITIONER

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the District Court is not officially reported, but is found in the record (pp. 51–55). The opinion of the Circuit Court of Appeals (R. 132–138) is reported in 95 F. (2d) 794.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 2, 1938 (R. 139). Petition for certiorari was filed May 28, 1938, and denied October 10, 1938. Upon petition for rehearing, order allowing certiorari was filed January 16, 1939 (R. 142). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the redemption and retirement in 1927, 1928, and 1929 of certain corporate bonds, pursuant to their terms, constitute the sale or exchange of a capital asset within the meaning of Sections 208 and 101 of the Revenue Acts of 1926 and 1928, respectively.

STATUTES INVOLVED

Revenue Act of 1926, c. 27, 44 Stat. 9:

> SEC. 208. (a) For the purposes of this title—
>
> (1) The term "capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921; * * *

The provisions of Section 101 (c) (1) of the Revenue Act of 1928, c. 852, 45 Stat. 791, are identical with the above.

STATEMENT

Petitioner owned several motion pictures upon which his basis for cost was $1,096,445.52. On March 5, 1925, he entered into a contract with the Elton Corporation, under which he transferred to that corporation his interest in the motion pictures in exchange for $4,000,000 par value of its bonds, to mature March 5, 1935, and 990 shares of its no-par-value stock (R. 60).

Under the contract the Elton Corporation obligated itself to redeem $100,000 face value of the bonds per year, beginning three years after the date

of the contract. The bonds contained a provision permitting their redemption by the corporation at any time upon 30 days' notice to the registered holder thereof (R. 60). The corporation did redeem, and petitioner surrendered for redemption, $1,600,000 of such bonds in 1927, $150,000 in 1928, and $150,000 in 1929 (R. 60–61).

Petitioner in his income-tax returns for 1927 and 1928 reported the sums received from the redemption of the bonds (R. 62, 63). He took no deduction for cost, but reported the full amount received as taxable at the capital gain rate of 12½ percent. For the year 1929 petitioner reported the amount received from the redemption of the bonds at the capital gain rate of 12½ percent, but claimed a cost of less than the amount later agreed upon in a settlement for prior years (R. 65–66).

In December 1929, petitioner and the Commissioner of Internal Revenue reached a settlement for the years 1917–1926, under which there was left to petitioner an unrecouped, unamortized cost of pictures of $1,096,445.52 (R. 64).

Petitioner filed claims for refund for the years 1927, 1928, and 1929, setting forth that he had not used the proper cost for the bonds redeemed (R. 67–71). The Commissioner on January 26, 1932, refunded to petitioner for the year 1927, $53,231.55, together with interest in the sum of $9,709.05; for the year 1928, $7,507.38, with interest in the sum of $932.40; for the year 1929, $677.56, with interest

in the sum of $42.99 (R. 72–73). Thereafter the Commissioner of Internal Revenue determined that the refunds were erroneous because the redemptions were not to be treated as capital gain,[1] and on July 6, 1933, officially demanded return to the Government of the sums refunded (R. 73–74). No part of the sums refunded has been returned (R. 74).

This action at law was instituted in the District Court on January 20, 1934 (R. 24), in accordance with Section 610 of the Revenue Act of 1928, to recover the sums of money erroneously refunded to the petitioner, together with interest thereon, at 6 percent per annum from the date of payment thereof. Jury was waived and the case was tried to the court, which held that the redemption of the bonds was not a "sale or exchange," and rendered judgment for the respondent in the sum of $72,186.94, with interest at 7 percent per annum from the date of demand of the return of the erroneous refunds to the date of judgment (R. 76–77). On cross-appeals, the Circuit Court of Appeals affirmed, with the modification that interest was allowed on the erroneous refunds at 6 percent per annum from the date of the payment of the said refunds (R. 139).

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[1] In fact application of both normal and surtax rates to the income shown in Findings XV (R. 62), XVII (R. 63), and XXIII (R. 65–66) discloses that *in addition* to the sums erroneously refunded, petitioner's tax had been *underpaid:* for 1927, by $91,160.64, for 1928, by $5,257.43, and for the year 1929, by $7,322.10. However, because of the bar of the statute of limitations, these sums are not involved in this suit.

This Court first denied petition for writ of certiorari, but upon petition for rehearing thereof, which pointed out conflict with *Averill* v. *Commissioner*, decided by the United States Circuit Court of Appeals for the First Circuit December 28, 1938 (not yet reported but may be found in 1939 C. C. H., Vol. 4, p. 9494),[2] order allowing certiorari in the instant case was entered January 16, 1939 (R. 142).

SUMMARY OF ARGUMENT

The issue here has been narrowed to whether the redemption or retirement of bonds constitutes a "sale or exchange" within the meaning of the statutory definition of "capital gain." The statute on its face is plain and unambiguous and admits of no resort to rules of statutory construction applicable to statutes of doubtful meaning. The rule repeatedly expressed by this Court that the intent of Congress is to be sought from the language used, and where this expresses an intention reasonably intelligible and plain it must be accepted without modification by resort to construction or conjecture, is controlling herein and calls for the rejection of petitioner's contentions.

But even resort to the legislative history of the pertinent provision does not aid the petitioner. Such history, as well as the decisions of this Court,

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[2] A copy of the opinion in *Averill* v. *Commissioner of Internal Revenue* is included in Brief for Petitioner, Appendix D, p. 36.

demonstrates that the statute is an inducing provision to encourage profit taking by offering a reduced tax to persons who would otherwise be reluctant to sell or exchange their capital assets. But it is clear that Congress could do nothing to encourage holders to redeem their bonds because the redemption was not a matter within their control. Thus it appears the original intent of the statute was to limit its benefits to those in a position to cooperate with the legislative policy and these benefits should not be extended by judicial construction in the absence of a clearly expressed intent.

The provision in question was first included in the Revenue Act of 1921 and re-enacted without modification in the subsequent acts until that of 1934. From 1921 to 1929 there was a uniform and consistent administrative interpretation which excluded redemption or retirement of bonds. Under established principles such interpretation is entitled to great weight and will not be disturbed except for compelling reasons, not present herein.

Moreover, the change made by the Revenue Act of 1934 was not of a declaratory or explanatory nature with respect to the intent of Congress under the prior acts. In such a situation the changes introduced into the later acts can not authorize construction of the earlier ones not consonant with the language there employed.

ARGUMENT

I

THE PERTINENT STATUTORY PROVISIONS ARE CLEAR AND UNAMBIGUOUS AND PERMIT OF NO JUDICIAL EXPANSION

The issue in the instant case has been narrowed to whether the "redemption" of bonds, pursuant to their terms, constitutes a "sale or exchange" of capital assets within the meaning of Section 208 (a) (1), Revenue Act of 1926, and Section 101 (c) (1), Revenue Act of 1928, so that the gain to petitioner upon such redemption is taxable at the "capital gain" rates rather than as ordinary income. These sections are substantially identical, providing:

> SEC. 208. (a) For the purposes of this title—
>
> (1) The term "capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921;
>
> * * * * *

Petitioner asks that this Court by judicial construction add to the statutory definition of "capital gain" taxable gain derived from the *redemption* of capital assets as well as from the "sale or exchange" thereof. This, we submit, may not be done. The statute is plain and unambiguous. It

refers to and includes only "sales or exchanges." There is no room for construction to enlarge or limit its meaning.

The intention of Congress is to be sought for primarily in the language used, and where this expresses an intention reasonably intelligible and plain it must be accepted without modification by resort to construction or conjecture. The recent reiteration of the rule by this Court in *Helvering* v. *City Bank Co.*, 296 U. S. 85, 89, is particularly apposite here:

> We are not at liberty to construe language so plain as to need no construction, or to refer to Committee reports where there can be no doubt of the meaning of the words used.

See also *Thompson* v. *United States*, 246 U. S. 547, 551; *Wilbur* v. *United States*, 284 U. S. 231, 237. This rule is applicable to taxing acts and to the definition of the words "sale or exchange," as used therein. *Old Colony R. Co.* v. *Commissioner*, 284 U. S. 552, 560; *Hale* v. *Helvering*, 85 F. (2d) 819, 821–822 (App. D. C.); *Watson* v. *Commissioner*, 27 B. T. A. 463; *Braun* v. *Commissioner*, 29 B. T. A. 1161; *Brown* v. *Commissioner*, 36 B. T. A. 178.

Accordingly, we submit that under fundamental principles of statutory construction petitioner's contentions here must be rejected.

II

THE REDEMPTION AND RETIREMENT OF THE CORPORATE BONDS INVOLVED DID NOT CONSTITUTE THE SALE OR EXCHANGE OF THE CAPITAL ASSETS WITHIN THE MEANING OF SECTIONS 208 AND 101 OF THE REVENUE ACTS OF 1926 AND 1928, RESPECTIVELY

Petitioner contends that the call and payment of the bonds by the obligor-corporation in 1927, 1928, and 1929 must be treated to the taxpayer for capital gain purposes in like manner as "the sale or exchange of capital assets" under Sections 208 (a) and 101 (c), *supra;* and that the term "sale or exchange" means and includes such payment or redemption.

Respondents maintain that the redemption and retirement of the bonds constituted neither a sale nor an exchange of capital assets, but payment, pursuant to call, of a fixed corporate obligation in accordance with its terms. The bonds on their face provided for their redemption at any time, at face value plus interest, upon notice to the registered holder thereof (R. 60). The corporation so redeemed and thus extinguished its obligations.

None of the elements of a sale or exchange is present. There was no transfer of title; there was a mere payment of a debt, and return of the evidence of that debt. "Sale" and "exchange" connote a transfer of property to a new owner. Neither can be one-sided. There can be no sale with-

out a purchase. There can be no exchange unless there be property parted with and property received by both parties. Certainly the corporation received no property for the cash it paid. The bonds it had issued were mere evidence of its obligation. *Commissioner* v. *Great Western P. Co.*, 79 F. (2d) 94, 96 (C. C. A. 2d), affirmed, 297 U. S. 543. Upon payment of the obligation, in accordance with its terms, that evidence was returned to the corporation.

It is plain, we submit, the taxable gain from the retirement and redemption of bonds is neither within the language nor the intent of the statute, which limits the special treatment provided therein to gains from the "sale or exchange" of capital assets. First of the revenue acts according special treatment to capital gains was that of 1921. The provision was reenacted in substantially identical form and was in effect under all the revenue acts from 1921 until 1934.

Petitioner concedes (Br. 10–11), the legislative history of the original provision shows (Pet. Br. 12–13), and this Court has held (*Burnet* v. *Harmel*, 287 U. S. 103) that these capital gain provisions were enacted for the purpose of relieving taxpayers coming within their provisions from excessive tax burdens on gains resulting from a sale or exchange of capital assets and to encourage their sale or exchange.

Thus it is generally recognized that the pertinent sections are inducing provisions. They grant a

reward (a reduction in rate) to those in a position to take advantage of their application. In cases where a taxpayer with a large increment in his investment hesitates to sell or exchange his holdings because of a high tax resulting therefrom, Congress by these provisions has encouraged such a person to dispose of such assets (sale or exchange) by granting a lower rate than that placed upon ordinary income. But it will be seen that the very purpose of these provisions can be of no effect in cases of redemption. In such a situation the bondholder (either in case of maturity or on call) has no option of retaining his investment or of parting with it. Regardless of how much he might wish to retain it, the redemption is entirely involuntary on the part of the holder, and it is clear that Congress could do nothing to encourage holders to redeem their bonds, because the redemption was not a matter within their control. The benefit of the statute should be limited to those who are in a position to cooperate with the legislative policy, and "sale or exchange" should be limited to its ordinary meaning and not extended to include redemption.

The rule of construction that a relief statute should be liberally construed to effectuate its purpose is not applicable when the question is whether the taxpayer is within the class intended to be relieved. It is, of course, well settled that one claiming an exemption from tax must bring himself squarely within the provisions of the statute under which he claims such exemption, and that rule is

equally applicable to a taxpayer who claims the benefit of exceptional treatment. *Bowers* v. *Lawyers Mortgage Co.*, 285 U. S. 182, 187. The same principle is applicable in analogous situations where statutory deductions are provided. *New Colonial Co.* v. *Helvering*, 292 U. S. 435, 440. The question here is whether the taxpayer disposed of his property in a transaction for which Congress offered a reward in the form of a reduction in rates. We submit that any doubt that the taxpayer is within the favored class must be resolved against him because in such cases "nothing is to be taken by inference or implication." *Riverdale Co-op. Creamery Ass'n* v. *Commissioner*, 48 F. (2d) 711, 713 (C. C. A. 9th).

From the foregoing discussion we think it plainly appears that it is the petitioner rather than the Government who must rely upon a technical and uncommon construction of the statute to support his position. The ordinary meaning of "redemption" is something different from that of a sale or exchange; its most common meaning is "to receive back by paying what is due"; specifically, it does not mean to "buy" or sell. Words and Phrases (2nd Series), Vol. IV, p. 220; Webster's International Dictionary. Cf. *Williamson* v. *Berry*, 8 How. 495, 544.

Nor do other provisions of the statute give force to the contention that Congress intended to include "redemption" within the phrase "sale or exchange." On the contrary, they indicate otherwise.

Section 204 of the statute provides the basis for determining gain or loss from the "sale or other disposition" of property, while Section 208 is limited to the gain derived from the "sale or exchange" of property. The latter phrase is clearly more limited than the former. "Redemption" and "sale" are not synonymous, and the tax result is entirely different in one case from that in the other. Even if the amount received on a redemption of bonds issued by a state would be exempt from the federal income tax, that exemption would not apply to a sale or exchange of the bonds. *Willcuts* v. *Bunn*, 282 U. S. 216.

Similarly, under the reorganization provisions of the statute dealing with "sales" and "exchanges" (Sections 203 and 112 of the Revenue Acts of 1926 and 1928, respectively), redemption by a corporation of its own securities can not properly be regarded as property "acquired"; the securities are merely extinguished. *Helvering* v. *Schoellkopf*, 100 F. (2d) 415 (C. C. A. 2d). See also *E. R. Squibb & Sons* v. *Helvering*, 98 F. (2d) 69 (C. C. A. 2d).

Giving effect to the plain language of the pertinent provisions, as well as their obvious purpose, we submit the statutory phrase "sale or exchange" may not reasonably be expanded to include "redemptions," as contended by petitioner. Manifestly, even a resort to the legislative history of the original provision negatives the contrary view

since the purpose was to encourage that class of investors who were in a position to take advantage of a reduction in rate by voluntary disposition of their property. Holders of bonds that are called or have matured are not in such a position.

III

THE CONSISTENT ADMINISTRATIVE INTERPRETATION OF THE STATUTE SUPPORTS THE CONSTRUCTION ADOPTED BELOW

As heretofore pointed out, the statute was first included in the Revenue Act of 1921. Article 1651 of Treasury Regulations promulgated thereunder, *infra*, provided that "gain" was taxable gain from the sale or exchange of capital assets only; gain upon redemption of bonds was not included therein. The regulations under the subsequent revenue acts to and including 1928 (see Appendix) were substantially identical and did not construe the similar provision to include redemptions. During three re-enactments (1924, 1926, and 1928) of the original provision there was thus a consistent administrative interpretation of the same statutory language and this, we submit, is entitled to great weight as showing the legislative intent. See *Helvering* v. *R. J. Reynolds Tobacco Co.*, No. 328, decided January 30, 1939; *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378; *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S. 488; *Brewster* v. *Gage*, 280 U. S. 327.

Not until 1929 was there a change in the administrative interpretation and such change followed from the decision of the Board of Tax Appeals in the case of *Werner* v. *Commissioner,* 15 B. T. A. 482, decided February 19, 1929, in which the Board held that a redemption of bonds was a "sale or exchange" thereof within the meaning of Section 206, Revenue Act of 1921. See I. T. 2488, VIII–2 Cum. Bull. 127 (1929), Appendix, *infra.* But the conclusion reached in the *Werner* case, we submit, is not justified by the legislative history of Section 206 recited therein.

Moreover, in 1932 the Board of Tax Appeals in the case of *Watson* v. *Commissioner,* 27 B. T. A. 463, reconsidered and expressly overruled its former decision in the *Werner* case, *supra.* The Commissioner of Internal Revenue promptly revoked the position taken, I. T. 2488, *infra,* and readopted the uniform interpretation which he had followed from 1921 to 1929. In the *Watson* case the Board held (p. 465):

> On further consideration we are of the opinion that the Board erred in its holding in *Henry P. Werner, supra.* It is elemental that where a statute is clear and unambiguous in its terms and provisions, resort should not be had to legislative history to determine the limits of its compass. The statute in question is so simple in construction and so clear in meaning that it justifies no resort to the Congressional Committee's reports as an aid in the interpretation thereof.

Such conclusion, we think, clearly is the correct view, and subsequently has been followed by the Board in its decisions. See *Braun* v. *Commissioner*, 29 B. T. A. 1161; *Rands* v. *Commissioner*, 34 B. T. A. 1107; *Brown* v. *Commissioner*, 36 B. T. A. 178. See also *Hale* v. *Helvering*, 85 F. (2d) 819 (App. D. C.); *Felin* v. *Kyle*, 22 F. Supp. 556 (E. D. Pa.).

IV

A CHANGE OF THE LAW WAS NECESSARY TO INCLUDE SUMS RECEIVED FROM THE REDEMPTION OF BONDS IN CAPITAL GAIN

By Section 117 (f), Revenue Act of 1934, c. 277, 48 Stat. 680 (U. S. C., Title 26, Sec. 101), Congress added to the capital gain provisions a section specifically providing that amounts received by the holder upon the retirement of bonds "shall be considered as amounts received in exchange therefor." The enactment is as follows:

> SEC. 117. * * *
>
> (f) *Retirement of Bonds, etc.*—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

The reason for the change is not explained in the Senate or House Committee Reports relating to the alterations made in the capital gains law by the Revenue Act of 1934. The change apparently followed a recommendation made by the Committee on Federal Taxation of the American Bar Association (Pet. Br. 24–25), which recommended during the hearings upon the 1934 Act that Congress redefine the term "capital gain" to include redemptions.

It is interesting to note that nowhere in the provision as enacted nor by reference in committee does it appear that Congress regarded the new provision as interpretative of the prior acts. It is established that in such a situation "nothing is to be taken by inference or implication." *Riverdale Co-op. Creamery Ass'n* v. *Commissioner,* 48 F. (2d) 711, 713 (C. C. A. 9th); *Shwab* v. *Doyle,* 258 U. S. 529, 536.

The contention of the petitioner that such change is only a clarifying or explanatory amendment of the existing law is wholly without support under applicable rules of statutory construction. The controlling principle in such a situation was stated by this Court in *Russell* v. *United States,* 278 U. S. 181, 188:

> The changes introduced into the Act of 1926 can not authorize construction of the earlier one not consonant with the language there employed.

Again, in a situation completely analogous to that here presented, where Congress in equally plain language had changed the previously existing law with reference to the right to charge off and deduct a portion of a debt, this Court said in *Spring City Co.* v. *Commissioner*, 292 U. S. 182, 187:

> We think that the fair import of this provision, as contrasted with the earlier one, is that the Congress, recognizing the significance of the existing provision and its appropriate construction by the Treasury Department, deliberately intended a change in the law. *Shwab* v. *Doyle*, 258 U. S. 529, 536; *Russell* v. *United States*, 278 U. S. 181, 188.

Similarly, in the case at bar we are dealing with a statute long in effect, plain and unambiguous on its face, and the subject of long and uniform administrative interpretation. If Congress had the purpose assigned by the petitioner, it should have declared it. When it had that purpose it did declare it in similarly plain and unequivocal language. *Shwab* v. *Doyle, supra; E. R. Squibb & Sons* v. *Helvering, supra; Felin* v. *Kyle*, 22 F. Supp. 556.

Petitioner here (Br. 24–31) makes much of the recommendation of a Committee of the American Bar Association during the Congressional hearings on the 1934 Act. He fails to call to the attention of this Court similar attempts and recommendations of individuals as well as bar committees to have the same change made during the hearings on the 1928 Act. The same change, and in

virtually identical language, was asked of Congress six years before 1934 by the Association of the Bar of the City of New York, J. M. Murphy, Esq., and A. A. Ballantine, Esq. See House Hearings, Revenue Revision 1927–1928, 70th Cong., 1st Sess., pp. 464, 472–474, 488; Senate Hearings on H. R. 1, 70th Cong., 1st Sess., p. 297.

It thus appears that at a time prior to the decision of the Board of Tax Appeals in the *Werner* case, *supra*, and at a time when the uniform interpretation of the capital gains provisions excluded the redemption or retirement of bonds as a "sale or exchange," Congress had considered and rejected the recommendation to make such a change. Certainly, in the light of the history of these recommendations which finally culminated in the change in the 1934 Act, it does not appear that Congress during the many years prior thereto had intended that redemption or retirement of bonds should be included in capital gains, and in 1934 enacted only a clarifying provision.

On the contrary, we think it plain that if Congress had intended the new section of the 1934 Act as declarative of the existing law, it would have said so. Not only did it not do this, but specifically provided in Title I, Section 1, Revenue Act of 1934 (U. S. C., Title 26, Sec. 1), that "The provisions of this title shall apply only to taxable years beginning after December 31, 1933." Moreover, any declaration of a possible retroactive effect with

respect to an earlier law must be "clear, strong, and imperative," as pointed out in *Shwab* v. *Doyle*, 258 U. S. 529, 536. See *United States* v. *Heth*, 3 Cranch 399, 413. "But no aid could possibly be derived from the legislative history of another act passed nearly six years after the one in question." *Penn Mutual Co.* v. *Lederer*, 252 U. S. 523, 538. See also: *Caminetti* v. *United States*, 242 U. S. 470, 490; *Smietanka* v. *First Trust & Savings Bank*, 257 U. S. 602, 607; *United States* v. *Field*, 255 U. S. 257, 264. And, in any event, the recommendation of the American Bar Association Committee at the 1934 hearings was not that Congress *clarify* the prior acts, but that it "redefine" the terms "capital gain" and "capital loss," and proposed an amendment adding the word "redemption" to "sale or exchange."

Certainly no plain purpose to change the status of cases arising under the earlier acts can be spelled out of the words in Section 117 (f), *supra*, or otherwise. The rule above quoted from *Russell* v. *United States* accordingly is applicable and precludes the interpretation of the section advanced by petitioner.

The decision of the First Circuit Court of Appeals in *Averill* v. *Commissioner*, *supra*, like that of the Board in the early *Werner* case, *supra*, disregards fundamental rules of statutory construction plainly controlling in the premises here. The court below, we submit, was eminently correct in

its observation as to the effect of Section 117 (f) when it said "If such intent had existed prior to 1934, it could and, we think would have found similar expression" (R. 137).

CONCLUSION

The decision of the court below is correct and should be affirmed.

Respectfully submitted.

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FEBRUARY 1939.

APPENDIX

Treasury Regulations 69, promulgated under the Revenue Act of 1926:

> ART. 1651. *Definition and illustration of capital net gain.*
>
> * * * * *
>
> "Capital gain" is taxable gain from the sale or exchange of capital assets consummated after December 31, 1921. * * *

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

> ART. 501. *Definition and illustration of capital net gain.*
>
> * * * * *
>
> "Capital gain" is taxable gain from the sale or exchange of capital assets consummated after December 31, 1921. * * *

Treasury Regulations 62 and 65:

> [Inasmuch as Articles 1651 of Treasury Regulations 62 and 65, promulgated, respectively, under the Revenue Acts of 1921 and 1924, are identical in all material respects with Articles 1651 and 501 of Regulations 69 and 74 above quoted, they are not set forth separately.]

I. T. 1637, II–1 Cum. Bull. 36 (1923):

> REVENUE ACT OF 1921
>
> Noninterest-bearing obligations of a political subdivision of a State were issued at 88 and upon maturity in the latter part of

1923 a taxable profit of 6x dollars will be realized by the holder, not the original purchaser. Inasmuch as the obligations have been held for over two years, inquiry is made whether the taxpayer will be subject to a tax on the capital net gain derived therefrom at the rate of 12½ per cent.

Section 206 of the Revenue Act of 1921 reads in part as follows:

> (a) That for the purpose of this title:
> (1) The term "capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

When an obligation matures it is neither sold nor exchanged. Any taxable profit derived upon maturity of a noninterest-bearing obligation is, therefore, not "capital gain" derived from the sale or exchange of capital assets and section 206 does not apply.

I. T. 2488, VIII–2 Cum. Bull. 127 (1929):

REVENUE ACTS OF 1921, 1924, 1926, AND 1928

The net gain from bonds held for more than two years, whether received as the result of the maturity of the bonds or as the result of their redemption before maturity, may, at the option of a taxpayer other than a corporation, be taxed as a capital net gain under the provisions of section 206 of the Revenue Act of 1921. I. T. 1637 (C. B. II–1, 36) revoked.

Likewise, any individual who has held stock in a corporation for more than two years and who derives a gain when the stock is "called in" may elect to have such gain taxed as a capital net gain in the manner and subject to the conditions prescribed in section 206 of the Revenue Act of 1921.

The foregoing ruling is also applicable under the Revenue Acts of 1924, 1926, and 1928.

A ruling is requested as to the manner in which the gain from bonds or stock held for more than two years should be treated where the bonds are redeemed before their maturity date or the stock is "called in."

Under the provisions of section 206 of the Revenue Act of 1921, any taxpayer (other than a corporation) who for any taxable year derives a capital net gain may elect to be taxed on such capital net gain at the rate of 12½ percent in lieu of the tax he would otherwise pay on such income under sections 210 and 211. Section 206 of the Revenue Act of 1921 reads in part as follows:

> (a) That for the purpose of this title:
> (1) The term "capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

In I. T. 1637 it was held that when an obligation matures it is neither sold nor exchanged. It was further held that any taxable profit derived upon maturity of an obligation is therefore not "capital gain" derived from the sale or exchange of capital assets and section 206 does not apply.

Under date of February 19, 1929, the United States Board of Tax Appeals decided, in the case of Henry P. Werner (15 B. T. A., 482, see on page 56), that the redemption of bonds at a "called" date for an amount in excess of the cost of the bonds to the bondholder results in a gain from the sale or exchange of capital assets within the meaning of section 206 of the Revenue Act of 1921. In the decision the legislative his-

tory of section 206 of the Revenue Act of 1921 was reviewed. It was stated that the Ways and Means Committee of the House and the Finance Committee of the Senate declared that the provision was intended to be applicable to the "sale or other disposition of capital assets."

The ruling contained in I. T. 1637 is hereby revoked. The net gain from bonds held for more than two years, whether received as the result of the maturity of the bonds or as the result of their redemption before maturity, may, at the option of a taxpayer other than a corporation, be taxed under the provisions of section 206 of the Revenue Act of 1921.

Likewise, any individual who has held stock in a corporation for more than two years and who derived a gain when the stock is "called in" may elect to have such gain taxed as a capital net gain in the manner and subject to the conditions prescribed in section 206 of the Revenue Act of 1921.

As the provisions of the Revenue Acts of 1924, 1926, and 1928 relating to capital net gains are similar to the provisions of section 206 (a) 1 of the Revenue Act of 1921, the foregoing ruling is also applicable under those Acts.

I. T. 2678, XII–1 Cum. Bull. 117 (1933):

REVENUE ACTS OF 1921, 1924, 1926, AND 1928

I. T. 2488 (C. B. VIII–2, 127), which holds that the gain derived from stock of a corporation "called in," or the gain derived from bonds as the result of their maturity or redemption before maturity, where such stock or bonds have been held for more than two years, may be taxed as a capital net

gain, is revoked, in so far as inconsistent with the decision of the Board of Tax Appeals in *John H. Watson, jr.*, v. *Commissioner* (27 B. T. A., 463, page 13, this Bulletin).

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